Social Security

International Update:

Recent Developments in Foreign Public and Private Pensions

May 2006

Europe

Malta

On March 1, 2006, the government of Malta released a pension reform plan that would increase the retirement age, lengthen the contribution period, raise the taxable income ceiling, and modify the minimum pension guarantee. The government expects to submit a bill to parliament by June, with an implementation date set for January 1, 2007.

The reform is based on the final report of the cabinet-led Pensions Working Group (PWG), and it largely captures the initial recommendations of the November 2004 White Paper drafted by the PWG. (See also the January 2005 issue of *International Update*.) During the national consultation process following the publication of the White Paper, the PWG commissioned several studies to gauge the impact of pension reform on the economy and measure public sentiment before submitting its final report to the government in June 2005.

Malta's social security system requires that employees and employers each contribute 10 percent of the employee's salary on earnings up to 6,958 lira (Lm) (US$20,492). The government provides an additional 50 percent of the total tax contributed to finance benefits for old-age, survivors, and disability; sickness and maternity; work injury; and family allowances. A full pension is paid after 30 years of contributions to men at age 61 and to women at age 60. The benefit is equal to two-thirds of the average earnings for a worker's best 3 of the last 10 consecutive calendar-year wages.

Once adopted, the reform would:

- Increase the retirement age for women to 61 to match the current retirement age for men beginning January 1, 2007. For men and women younger than age 45 as of that date, the benefit eligibility age would be 65, and for those aged 55 or older it would be 61. Intermediate retirement ages would apply as follows: the retirement age would increase to age 64 for those aged 46 to 48; to 63 for those aged 49 to 51; and to 62 for those aged 52 to 54. Early retirement would be discouraged but could be possible from age 62 with a reduction in the pension benefit. Workers choosing to remain in the workforce after reaching age 65 could receive a full pension and would not have to contribute further to social security.
- Lengthen the contribution period to qualify for a full pension from 30 to 40 years on the basis of the age of the individual as of January 1, 2007. There would be no change for persons aged 35 or older. Those aged 25 or younger would be required to contribute to the pension system for 40 years. There would be a graduated change in the number of contribution years for persons between the ages of 25 and 35. The pension calculation for those aged 46 or older as of January 1, 2007, would remain based on the best 3 consecutive years of the last decade of their working life, but for younger workers the calculation would be based on the best 10 of the last 20 years of earnings.
- Gradually raise the taxable income ceiling from the current Lm 6,958 (US$20,492) to Lm 9,000 (US$26,598) by 2014.
- Change the formula for the guaranteed minimum pension from the current four-fifths of the minimum wage, which was Lm 2,421 (US$7,154) in 2005, to 60 percent of the national median income, which was Lm 2,036 (US$4,424) in 2001. The new rate would be adjusted periodically for inflation and for changes in the median income.

There will be further study of a possible mandatory second-pillar pension. The government is exploring whether to provide tax incentives and a carve-out of a small percentage of current public pension contributions to fund a second-pillar defined contribution pension.

Malta's pension system is under considerable pressure because of gains in life expectancy (more than 79 years for those born in 2006) and a sharp decline in fertility rates (1.5 children per female in 2006). The proportion of the population aged 61 or older is projected to grow from roughly 16 percent in 2003 to 19 percent in 2010 and to reach nearly 30 percent in 2050. According to official statistics, the 2005 public pension expenditure of Lm 58 million (US$171 million) was 51 percent above the level recorded in 2000. The public pension deficit in 2003 represented a deficit of 0.6 percent of gross domestic product (GDP). Without reform, the shortfall is projected to reach 2.6 percent of GDP by 2010 and increase to 4.9 percent of GDP by 2020 before declining to 3.9 percent of GDP by 2050.

Sources: International Monetary Fund, October 2005; U.S. Central Intelligence Agency, *World Factbook*, 2006; European Commission, Economic and Financial Affairs, 2006; Pensions Working Group,

Pensions: Adequate & Sustainable (March 1, 2006); Malta Media, March 1, 2006; *Times* (Malta), March 2, 2006; *Business Today* (Malta), March 29, 2006; *Malta Independent*, April 5, 2006; *Social Security Programs Throughout the World: Europe, 2006* (forthcoming).

The Americas

Chile

On April 11, 2006, Congress passed a law to increase the minimum pension benefit and the means-tested assistance pension by 10 percent, beginning May 1. The additional US$180 million annual cost will be financed by maintaining the country's value-added tax (VAT) at 19 percent instead of lowering it to 18 percent in 2007 as set by the previous administration. The new law, the first passed by congress under the new administration of President Michelle Bachelet, is part of the president's plan to improve Chile's social welfare system. (See also the April 2006 issue of *International Update*.)

The government provides a minimum pension under the old public pension system, which was closed to new entrants in 1983, and a top-up subsidy to reach the minimum threshold under the individual accounts system that replaced the old system. To qualify for the minimum pension, men aged 65 and women aged 60 must have contributed to an individual account for 20 years, and their total income—pension from an individual account plus other sources of income—must fall short of the minimum level set by the government. The number of contributions required for the old system's minimum pension is 20 years for male blue-collar workers and 10 years for female blue-collar workers and all white-collar employees. Today, about 90 percent (1.2 million) of retirees under the old public pension system receive the minimum pension, and some 60,000 under the individual account system, or about 18 percent of retirees covered, receive the top-up subsidy.

The minimum pension and the threshold for the top-up subsidy have three levels, depending on the age of the retiree. The monthly minimum pension benefit for those younger than age 70 rose from 79,867 to 87,854 pesos (US$160 to $176); for those between the ages of 70 and 75, the benefit went from 87,328 to 96,061 pesos (US$175 to $192); and for those over the age of 75, from 93,176 to 102,494 pesos (US$186 to $205).

Although the minimum pension benefit is adjusted annually for inflation, additional ad hoc increases have been made over time. Historically, the minimum benefit has been between 25 percent and 29 percent of the average wage. The recent 10 percent increase in the minimum pension benefit is on top of the annual inflation adjustment.

The new law also increased by 10 percent the means-tested benefits (*Pasis*) that are provided to low-income individuals who are either disabled or over the age of 65 and do not qualify for any type of pension. *Pasis* benefits also depend on age. The monthly benefit for persons below the age of 70 rose from 40,169 to 44,186 pesos (US$80 to $88); for those between ages 70 and 75, it went from 42,821 to 47,103 pesos (US$85 to $94); and for those over the age of 75, from 46,821 to 51,593 pesos (US$94 to $103). As a budgetary control, the government sets a limit on the number who can receive *Pasis* benefits. At present, the limit is 400,000, but President Bachelet intends to introduce a bill to expand access to these benefits, which over time could result in an additional 100,000 beneficiaries.

Sources: *Social Security Programs Throughout the World: The Americas, 2005*; latercera.cl, March 20 and 23, 2006; *El Mercurio* (Santiago de Chile), 30 de marzo de 2006; Biblioteca del Congreso Nacional de Chile, Noticias, 4 de abril de 2006; U.S. Fed News, April 17, 2006; Business News Americas, April 20, 2006; Europa Press-Servicio Latinoamericano, 20 de abril de 2006.

Jamaica

The Jamaican parliament passed new regulations in April that increase the obligations and responsibilities of the private pension industry. These new regulations are part of the implementation of a pension law passed in July 2004 that provides a comprehensive regulatory and supervisory framework for voluntary privately managed plans. (See also the October 2004 issue of *International Update*.)

The new regulations require that voluntary defined benefit and defined contribution pension funds, fund trustees, investment managers, and administrators register with the Financial Services Commission (FSC), an independent government body that supervises and regulates the securities, insurance, and private pension industries. Before the new regulations, fund members would receive annual updates only about their contributions, but now the funds are required to provide members with information about the management and operation of their fund. In addition, pension funds must obtain FSC approval before winding up.

The new regulations provide additional responsibilities for pension fund trustees. Trustees must ensure that pension fund assets match liabilities. They must develop investment policies and anti-money laundering procedures, member complaints, and conflicts of interest. Pension funds will have to comply with the new regulations by September 29, 2006.

Jamaica's public pension system, the National Insurance Scheme, is supplemented by voluntary private pensions. The National Insurance Scheme is a contributory pension plan, with employers and employees each paying 2.5 percent of gross wages. It pays flat-rate and earnings-related benefits to men beginning at age 65 and to women at age 60. The flat-rate benefit is determined by the average number of weeks that a worker has contributed to the system. Currently, a

worker who has contributed for an average of 39 weeks a year is entitled to receive a benefit of J$3600 (US$55) per month. Incrementally lower benefits are paid to workers with fewer than 39 weeks of contributions a year. The earnings-related benefit is J$0.06 a week for every J$13 (US$0.21) of the combined 5 percent of gross wages paid by employers and employees.

Sources: *Social Security Programs Throughout the World: The Americas, 2005*; The Jamaica Gleaner Online, March 30 and April 23, 2006; *The Jamaica Observer* (Kingston), April 7 and 11, 2006; Business News Americas, April 19, 2006.

Asia and the Pacific

China

On May 1, the government authorized the National Social Security Fund (NSSF), which serves as a reserve fund for China's public pension system, to invest in overseas assets. Initially, international investments will be limited to the purchase of shares of mainland Chinese companies trading on the Hong Kong Exchange. Investing NSSF funds in international markets is part of a larger investment plan that also includes increasing investments in domestic banks and equities.

The National Social Security Board, which oversees the NSSF, has been seeking non-Chinese pension custodians to advise and service the fund's foreign investments. The pension custodians are required to hold more than US$5 billion in capital during the immediate fiscal year or at least US$500 billion in custodial assets. Eligible custodians must also be internationally rated for the previous 3 years and have a rating of A or higher.

NSSF investment returns have historically been low because the majority of its assets have been invested in low-yielding domestic bank deposits. The new investment strategy is designed to provide a higher overall rate of return. At the end of 2005, the NSSF held assets valued at 201 billion renminbi (US$25 billion).

The NSSF was established in 2000 as a reserve fund for the decentralized public pension system that operates in each of China's 30 provinces. If a province's public pension system experiences a deficit, it can tap the NSSF for financial assistance. The NSSF is financed by a portion of the proceeds from the sale of state-owned assets, profits from national lotteries, and allocated general tax revenue. (See also the March 2004 issue of *International Update*.)

Sources: Dow Jones International News, March 28 and April 10, 2006; *South China Morning Post* (Hong Kong), April 21, 2006; *Financial Times* (London), May 1, 2006; China View, May 2, 2006.

Africa

Nigeria

Nigerian workers are now able to establish privately managed retirement savings accounts (RSAs) under the new mandatory funded pension system. Since February 20, 2006, new financial companies have been licensed to operate under this new pension system. So far, the approved companies include 18 pension fund managers or administrators (PFAs), 1 closed-end pension fund administrator (CPFA), and 7 pension fund custodians (PFCs). Once the new pension system is fully operational, it is projected to collect 6 billion naira (US$47 million) in monthly contributions.

The new system combines the formerly separate pension programs for public- and private-sector workers into a single privately managed funded system. (See also the September 2004 issue of *International Update*.) Under the new law, public-sector federal employees and workers in private-sector firms with five or more employees must open an individual retirement savings account with a PFA of their choice. Workers may switch PFAs once a year. Both employees and employers contribute 7.5 percent of employee earnings into an RSA monthly. Fifteen percent of earnings is also contributed on behalf of military personnel, but the government contributes 12.5 percent and the military employee contributes 2.5 percent. PFAs select a PFC that will receive and hold all pension fund assets and execute transactions for the account holder as instructed by the PFA. Contributions and retirement benefits are tax-exempt.

Implementation of the new pension system for public-sector and military employees began in 2004, and private-sector employees were added in 2005. Since July 1, 2004, public-sector employee and employer contributions have been held in a special interest-bearing account with the Central Bank of Nigeria. Assets currently held amount to around 60 billion naira (US$467 million). Since January 1, 2005, private-sector employers with five or more employees have been required to direct employer and employee contributions into escrow accounts earning nominal interest. Employees in smaller firms and the self-employed may, but are not required to, participate in the new pension system. Also exempt from participation are employees of state and local governments, judges, and employees with 3 years or less remaining until retirement.

At retirement, a worker may withdraw funds from an RSA account for programmed monthly or quarterly withdrawals calculated on the basis of life expectancy, a quarterly or monthly life annuity purchased from a life insurance company, or a lump sum of the balance remaining after the worker has purchased an annuity or established a programmed withdrawal equal to the replacement of at least 50 percent of preretirement monthly salary. A preretirement lump-sum

distribution is possible from age 50 following a period of involuntary unemployment lasting at least 6 months. Employees contributing for at least 20 years are entitled to a guaranteed minimum pension in an amount yet to be specified by the government.

Under the new pension system, supervisory authority is vested in a newly created National Pension Commission (NPC). The NPC has responsibility for licensing, approving, regulating, and monitoring the investment activities of PFAs and PFCs. Specific NPC guidelines determine the investment of pension fund assets, which may include government securities, shares issued by listed corporations, and approved foreign investment instruments.

The new funded system replaces the noncontributory pay-as-you-go system for public-sector employees and military personnel; the National Social Insurance Trust Fund, a contributory private-sector system; and voluntary employer-sponsored retirement plans. The public-sector pension system was plagued by poor administration and payment delays that resulted in a deficit currently estimated at nearly 2 trillion naira (US$16 billion). A framework for clearing pension liabilities and arrears from the old public-sector program, as well as determining the cost of transition to the new funded system, is expected by the end of June.

Sources: All Africa, January 26 and April 27, 2005, February 21 and 27, 2006; *This Day* (Nigeria), August 23, 2005, and March 5, 2006; US–Africa Summit of the Corporate Council on Africa, June 2005, Baltimore, MD; *Journal of Insurance Regulation*, Winter 2005; International Monetary Fund, August and December 2005; *Nigerian Tribune* (Nigeria), February 2, 2006; *The Tide* (Nigeria), March 17, 2006; business.dayonline.com, April 14, 2006; *Vanguard* (Nigeria), April 14, 2006; and *Daily Independent* (Ikeja), April 20, 2006.

Reports and Studies

This spring the Organisation for Economic Co-operation and Development (OECD) issued guidelines to make asset management and regulatory oversight of occupational private pension funds more efficient and transparent. The guidelines are based on a pension fund survey of the 30 OECD member countries and are directed at the more than 1 million pension funds worldwide, which held more than US$16 trillion in private pension fund assets in 2005.

The survey examined three broad areas of pension fund management and regulatory oversight: (1) domestic asset portfolio limits, (2) foreign asset investment limits, and (3) quantitative limits for portfolio risks and ownership concentration by issuer or asset class.

The guidelines should serve as a roadmap for occupational, voluntary, mandatory, defined benefit, and defined contribution pension funds as well as for pension fund regulators and supervisors. The following recommendations were made:

- Adopt the *prudent person* approach to managing pension assets. This standard provides that fund managers and others handle pension fund assets with prudence, discretion, intelligence, and regard for the safety of capital as well as income.
- Develop and follow a written investment policy that is consistent with the retirement income objectives and liabilities of the pension fund.
- Mandate that pension fund trustees or board members act in the best interest of pension fund beneficiaries.
- Establish and monitor internal governance, accountability, and transparency controls.
- Identify, measure, and monitor risks associated with investing pension fund assets.
- Disclose pertinent fund management information such as performance, market values, and fees.
- Strive for fund diversification and allow for foreign investments: avoid minimum levels of investments in any asset category and limit investing in particular companies, such as the fund's sponsoring company, its asset manager, or its other providers.

These international standards and best practices for OECD members stress the principles of security, profitability, and liquidity in the management, regulation, and supervision of occupational pension fund assets. These guidelines do not specifically address nonoccupational pension funds or plans, but they can apply to other types of pension plans as well as pension plans in non-OECD countries.

Within 3 years, the OECD plans to examine the extent to which member countries have adopted and implemented the guidelines to ascertain if progress has been made in improving the efficiency of managing and supervising private pension funds.

Source: *OECD Guidelines on Pension Fund Asset Management*, March 23, 2006, http://www.oecd.org/dataoecd/59/53/36316399.pdf.

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Editor: Susan A. Carleson.

Writers/researchers: Denise Lamaute, Barbara E. Kritzer, David Rajnes, and Craig Romm.

Social Security Administration
Office of Policy
Office of Research, Evaluation, and Statistics
500 E Street, SW, 8th Floor
Washington, DC 20254

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